United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

74-2053-4

To be argued by
JAMES R. HAWKINS, II

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United States Court of Appeals
FOR THE SECOND CIRCUIT

Docket No. 74-2053
Docket No. 74-2054

GEORGE KATZ,
Plaintiff-Appellee,
against
REALTY EQUITIES CORPORATION OF NEW YORK *et al.*,
Defendants-Appellees,
and
KLEIN, HINDS & FINKE
and
ALEXANDER GRANT & COMPANY
Defendants-Appellants.

KENNETH I. HERMAN, Trustee
F/B/O SHERIL ESTA KUPFER,
Plaintiff-Appellee,
against
REPUBLIC NATIONAL LIFE INSURANCE COMPANY *et al.*,
Defendants-Appellees,
and
KLEIN, HINDS & FINKE
and
ALEXANDER GRANT & COMPANY
Defendants-Appellants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANTS-APPELLANTS KLEIN, HINDS & FINKE AND ALEXANDER GRANT & COMPANY

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TABLE OF CONTENTS

Cases Cited

Other Authorities Cited

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Preliminary Statement

This appeal is from the Order of Consolidation of the Honorable Milton Pollack, dated June 24, 1974, which directed plaintiffs' liaison counsel to prepare and serve a

single consolidated complaint (107a).[1] That order compelled the merger of twelve distinct actions into one suit alleging derivative, individual and class claims. The merger has adversely and materially affected the rights of appellants Klein, Hinds & Finke ("KHF") and Alexander Grant & Co. ("Grant").

This appeal is proper at this time under *Cohen v. Beneficial Indus. Loan Corp.*, 337 U. S. 541 (1949) and this Court's decisions in *Garber v. Randell*, 477 F.2d 711, 715 (2d Cir. 1973); *Farber v. Riker—Maxson Corp.*, 442 F.2d 457, 459 n.1. (2d Cir. 1971); *MacAlister v. Guterma*, 263 F.2d 65, 69 (2d Cir. 1958).

Question Presented

Did the district court lack the authority to merge a variety of claims asserted in twelve separate actions by ordering the filing of a consolidated complaint?

Statement of the Case

The appellants Grant and KHF are two firms of accountants whose practices were combined as of September 1, 1969. Prior to that date, KHF was accountant for Realty Equities Corporation of New York ("REC"), and thereafter, Grant acted as REC's accountant until the autumn of 1970.

On March 8, 1974 the Securities and Exchange Commission ("SEC") filed a complaint in the United States District Court for the Southern District of New York (74 Civ. 1097) against REC, Republic National Life Insurance Company ("Republic") and other [illegible] *including Grant or*

1. References in this form are to the Appendix submitted herewith.

KHF. The SEC complaint seeks injunctive relief based on alleged violations of the federal securities laws arising out of certain transactions between REC and Republic. Almost immediately thereafter, private actions inspired by the SEC suit were filed. By May 3, 1974 twelve private actions had been filed in the Southern District of New York. Grant and KHF were named defendants and served in only two of these actions: *Katz v. Realty Equities Corporation of New York et al.* ("Katz") 74 Civ. 1137, commenced March 12, 1974; and *Herman v. Republic National Life Insurance Company et al.* ("Herman") 74 Civ. 1248, commenced March 18, 1974.[2] The *Katz* and *Herman* actions were brought as class actions on behalf of common stockholders of REC and Republic, respectively. Except for the addition of Grant and KHF as defendants, the *Katz* and *Herman* complaints, which were filed within ten days of the SEC complaint, are virtually identical to it.

On June 12, 1974 the district court, *sua sponte,* held a hearing for the purpose of determining whether it should consolidate *Katz, Herman* and the ten other actions in the Southern District which had been spawned by the SEC complaint (77a).[3] Counsel for Grant and KHF opposed consolidation at the hearing (91a-94a). The district court

2. Grant and KHF were named as defendants, but not served, in two other suits: Chesner v. Karp, 74 Civ. 1846, commenced April 26, 1974; and Asarian v. Karp, 74 Civ. 1942, commenced May 3, 1974.

3. The ten other actions are: Miller v. Republic National Life Ins. Co. *et al.*, 74 Civ. 1115, commenced March 11, 1974; Cohen *et al.* v. Realty Equities Corp. of New York *et al.*, 74 Civ. 1192, commenced March 14, 1974; Sussman *et al.* v. Republic National Life Ins. Co. *et al.*, 74 Civ. 1225, commenced March 15, 1974; Rubenstein v. Republic National Life Ins. Co. *et al.*, 74 Civ. 1255, commenced March 18, 1974; Ferber v. Beasley *et al.*, 74 Civ. 1294, commenced March 20, 1974; Tisser v. Karp *et al.*, 74 Civ. 1622, commenced April 10, 1974; Freeman, *etc.* v. Republic National Life Ins. Co. *et al.*, 74 Civ. 1668, commenced April 12, 1974; Chesner v. Karp *et al., supra;* Gottlieb, *etc.* v. Realty Equities Corp. of New York *et al.*, 74 Civ. 1875, commenced April 29, 1974; Asarian, *etc.* v. Karp *et al., supra.*

filed an Order of Consolidation on June 24, 1974 which, in addition to consolidating the twelve cases for pretrial purposes:

> 1. appointed liaison counsel and directed him to prepare and serve a single consolidated complaint; and
>
> 2. provided that the answer of each defendant to the consolidated complaint shall be deemed to assert cross-claims in the nature of contribution and indemnification against all other defendants, except insofar as any defendant shall in his answer decline to assert such claims against any other defendant.

On August 22, 1974 the Judicial Panel on Multidistrict Litigation ordered the transfer to the Southern District of New York of five additional actions to which Grant and KHF were not parties (242a); and on August 26, 1974, *sua sponte* and without a hearing, Judge Pollack ordered these five actions consolidated with the original twelve (250a). An amended consolidated complaint[4] (126a) was prepared and was served on Grant and KHF on or about October 16, 1974.

The amended consolidated complaint is purportedly brought by twenty-one plaintiffs against thirty-nine defendants. The complaint contains thirty-three counts, thirty of which purport to state claims on behalf of a total of five different classes,[5] two counts purport to state derivative claims, one on behalf of each of Republic and REC, and one count is an individual claim. The claims are alleged to be based on the Securities Act of 1933, 15 U.S.C. §77a *et*

4. The original consolidated complaint was deemed by the district court to be a draft (226a-230a).

5. The five classes consist of persons who purchased and/or owned securities of Republic and REC, shares of Pacific National Life Assurance Company, certain debentures of REC and shares of the common stock of Mercantile Security Life Insurance Company at certain relevant times.

seq., the Securities Exchange Act of 1934, 15 U.S.C. §78a *et seq.*, the Rules and Regulations promulgated thereunder, 17 C.F.R. §240, the Trust Indenture Act of 1939, 15 U.S.C. §77aaa *et seq.*, the Texas Business and Commerce Code and principles of the common law relating to breach of contract and fraud.

Grant and KHF are not named in thirty of the thirty-three counts.[6] The claims against Grant and KHF are limited. There is no allegation that they participated in the complex real estate and financial transactions between REC and Republic which are at the core of the amended consolidated complaint. It is merely alleged that Grant and KHF discovered or knew of certain material problems between REC and Republic and that they breached a duty of disclosure to the public and the SEC (159a, 177a, 183a). The issues which predominate in the mainstream of the complaint revolve around a series of complicated transactions between and among REC, Republic and their respective affiliates. It can be anticipated that these transactions will require extensive factual inquiry during pretrial discovery. However, the claims asserted against Grant and KHF, if any, involve fundamental legal questions of an accountant's obligations to clients, the public and governmental agencies.

The claims against Grant and KHF are further limited since the claims in the amended consolidated complaint are asserted to have arisen between September, 1970 and March, 1974, but Grant was terminated as accountant for

6. Grant and KHF are named in Counts VII, XIX and XXI, each of which are based solely on Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. Counts VII and XIX are brought on behalf of purchasers of securities of Republic and REC, respectively, between September 1, 1970 and March 8, 1974. Count XXI is a derivative count on behalf of REC.

REC in the autumn of 1970, after having issued a report which disclaimed an opinion of REC's financial statements for the fiscal year ended March 31, 1970 (9a, 36a, 47a, 73a, 159a).

Grant and KHF have been seriously prejudiced by the order appealed from in at least two ways. First, the classes which assert claims against Grant and KHF in the amended consolidated complaint are broader and different from the classes alleged in *Katz* and *Herman*. Counts VII and XIX of the amended consolidated complaint (158a, 176a) appear to have subsumed the claims against Grant and KHF in the *Katz* and *Herman* complaints. Count VII is brought on behalf of the "Republic Class" which is defined to include "all persons who purchased *securities* of Republic . . ." (emphasis added) (127a). The class designated in the *Herman* complaint (Count VII's analogue) includes those persons "who purchased *common stock* of Republic . . ." (emphasis added) (41a). Similarly the "Realty Class", claimant in Count XIX, is comprised of purchasers of *securities* of REC. However, the *Katz* class (Count XIX's analogue) was defined in terms of purchasers of *common stock* of REC or an affiliate. This change of classes, made solely as a result of the consolidation order, could have a significant impact on the extent of damages, if any. REC is a real estate investment company (134a) and Republic is an insurance company (133a). There are a great number and variety of investment instruments which these companies issue other than common stock which could be found to be "securities".

Second, Grant and KHF must now not only defend against claims asserted by *Katz* and *Herman* but also against cross-claims for contribution and indemnification by all other defendants as specified in the Order of Consolidation. Judge Pollack has indicated that eventually all

of the constituent actions may be consolidated for all purposes (79a, 94a). Accordingly, Grant and KHF must now prepare for trial as if each of thirty-seven co-defendants had asserted cross-claims against them.

ARGUMENT

The district court lacked the authority to merge a variety of claims asserted in twelve separate actions by ordering the filing of a consolidated complaint.

The single issue presented on this appeal is whether the district court exceeded its authority by directing a consolidated complaint to be prepared and served, thereby effecting a merger of the claims in twelve (and ultimately seventeen) actions.

The legal principles regarding consolidation were decided by the Supreme Court over forty years ago.

> "[C]onsolidation is permitted as a matter of convenience and economy in administration, but does not merge the suits into a single cause, or change the rights of the parties, or make those who are parties in one suit parties in another." *Johnson* v. *Manhattan Ry. Co.*, 289 U. S. 479, 496-97 (1933).

Accord, Garber v. Randell, 477 F.2d 711, 715 (2d Cir. 1973); *Zdanok v. Glidden Co.*, 327 F.2d 944, 950 n.6 (2d Cir.), *cert. denied*, 377 U. S. 934 (1964); *Greenberg v. Giannini*, 140 F.2d 550, 552 (2d Cir. 1944) (per L. Hand, C.J.); *Journapak Corp. v. Blair*, 27 F.R.D. 509, 510-11 (S.D.N.Y. 1961); 5 J. Moore, Federal Practice ¶ 42.02, at 42-21 (2d ed. 1973); 9 C. Wright & A. Miller, *Federal Practice & Procedure: Civil* § 2382 at 255 (1972).

The strictures placed by the Supreme Court on consolidation are violated where a party is deprived the opportunity of having his rights determined by the pleadings in that case. *National Nut Co. v. Susu Nut Co.*, 61 F. Supp. 86, 88 (N.D. Ill. 1945). That deprivation is exacerbated here, where the substituted pleading purports to state claims against Grant and KHF on behalf of classes of persons who did not originally seek to state claims against them.

This Court's recent decision in *Garber v. Randell, supra,* is dispositive of the issue presented by this appeal. In *Garber,* the district court had ordered the consolidation for pretrial purposes of three class actions and, in addition, required the filing of a consolidated complaint. The three class actions stated numerous claims under the federal securities laws against National Student Marketing Corp., its officers, directors, accountants and attorneys (including the firm of White & Case) and certain investment banking houses and public relations firms. White & Case was a defendant in one of the three actions, and the claims asserted against it were "relatively narrow and limited as to scope, subject matter and time, in contrast to the broad claims" asserted against other defendants. 477 F.2d at 716. White & Case appealed the consolidation order, and this Court held that where, as in the instant appeal, numerous unrelated claims are ordered consolidated for pretrial purposes, it was improper to direct the filing of a consolidated complaint against White & Case ("W&C"):

> "To permit such limited claims against W&C to be joined with numerous unrelated claims by other purchasers against some 50-odd other defendants in one 'mixed bag' type of consolidated complaint would be fundamentally unfair and would violate the principles underlying our decision in MacAlister v. Guterma, supra, and the unbroken line of authority

> going back to Johnson v. Manhattan Railway Co., supra. Nor is the prejudice to W&C alleviated by designation of the claims against it separately in Paragraphs 16 to 29 as claims asserted solely by Natale. This mere change in form does not serve to avoid the harm threatened by the merger of all claims into a single cause." *Garber v. Randell, supra,* at 717.[7]

The amended consolidated complaint here is precisely the "mixed bag" type of consolidated complaint which concerned this Court in *Garber*. To inflict such a complaint on Grant and KHF, which are not alleged to have participated in the central wrongdoings, clearly contravenes the principles prohibiting the merger of claims by consolidation. The principles underlying this Court's decision in *MacAlister v. Guterma, supra,* and relied on in *Garber* were clearly stated in *MacAlister*:

> "But while the district courts are invested with the power to consolidate actions for all purposes and to appoint a general counsel they have no such authority to order a consolidated complaint as requested by appellant. See Levin v. Skouras, [Civ. 38-422 (S.D.N.Y. March 21, 1974)]; National Nut Co. of Cal. v. Susu Nut Co., supra. Such an order would tend to merge the various actions in disregard of the caveat expressed in Johnson v. Manhattan Ry. Co., 1933, 289 U. S. 479, 496-497, 53 S. Ct. 721, 77 L.Ed. 1331." *MacAlister v. Guterma, supra,* at 69.

It should be noted that there is considerable doubt, apparently shared by some of plaintiffs' attorneys (85a, 219a), whether a district court possesses the authority to consolidate class actions with derivative actions. *Gordon*

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7. It should be noted that this Court's opinion in *Garber* v. *Randell, supra,* was limited to White & Case because it alone appealed from the order of consolidation.

v. Fundamental Investors, Inc., 362 F. Supp. 41 (S.D.N.Y. 1973) (Gurfein, D.J.); ***Hawk Indus. Inc. v. Bausch & Lomb, Inc.***, 59 F.R.D. 619 (S.D.N.Y. 1973); *Ruggiero v. American Bioculture, Inc.*, 56 F.R.D. 93 (S.D.N.Y. 1972).

While the direction by the district court for the filing of a consolidated complaint herein was prejudicial in itself, the prejudice was aggravated by the provision in the order appealed from for the automatic assertion of cross-claims against Grant and KHF by all other defendants. By that provision, the district court has effectively fashioned an opt out rule whereby inadvertence will result in the assertion of cross-claims.

Conclusion

Insofar as the order appealed from directs that a consolidated complaint be filed against Grant and KHF, it should be reversed.

Respectfully submitted,

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December 4, 1974

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BY MAIL

STATE OF NEW YORK,

COUNTY OF NEW YORK.

The undersigned being duly sworn deposes and says:

1. I am not a party to the action, am over eighteen years of age and reside at

2. On the 4 day of DECEMBER, 1974, at about 4 o'clock P .m., I served a true copy of the Joint Appendix and two true copies of the annexed Brief for Defendants-Appellants Klein, Hinds & Finke and Alexander Grant & Company upon:

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Sworn to before me this
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Gilbert H. Bleich

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